# Audit Report

THE PRIOR PERIOD ADJUSTMENT TO REMOVE NATIONAL DEFENSE PROPERTY, PLANT, AND EQUIPMENT FROM THE ARMY GENERAL FUND BALANCE SHEET

Report No. D-2000-165 July 21, 2000

Office of the Inspector General
Department of Defense

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## Acronyms

| | |
|---|---|
| ACSIM | Assistant Chief of Staff of the Army for Installation Management |
| DFAS | Defense Finance and Accounting Service |
| LOGSA | Logistics Support Activity |
| OMB | Office of Management and Budget |
| PP&E | Property, Plant, and Equipment |
| RSSI | Required Supplementary Stewardship Information |
| SFFAC | Statement of Federal Financial Accounting Concepts |
| SFFAS | Statement of Federal Financial Accounting Standards |

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

July 21, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on the Prior Period Adjustment to Remove National Defense Property, Plant, and Equipment From the Army General Fund Balance Sheet (Report No. D2000-165)

We are providing this report for review and comment. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The report is one of two reports on National Defense property, plant, and equipment. We considered management comments on a draft of the report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service comments were partially responsive. We request additional comments on Recommendations 2.a., 2.b., and 2.c. We request that the Director, Defense Finance and Accounting Service, provide comments by September 19, 2000.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. David F. Vincent at (703) 604-9109 (DSN 664-9109) (dvincent@dodig.osd.mil) or Mr. John A. Richards at (703) 604-9133 (DSN 664-9133) (jrichards@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

## Office of the Inspector General, DoD

**Report No. D2000-165** **July 21, 2000**

Project No. D2000FH-0080.001
(formerly Project No. 0FH-2109.01)

# The Prior Period Adjustment to Remove National Defense Property, Plant, and Equipment From the Army General Fund Balance Sheet

## Executive Summary


**Introduction.** This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The audit report addresses the FY 1998 requirement to remove all dollar amounts representing the new categories of stewardship property, plant, and equipment from the balance sheet by means of a prior period adjustment. For FY 1998, the Army General Fund had a prior period adjustment of about $144.5 billion and reported all of it as removal of National Defense property, plant, and equipment from the balance sheet. This report is one of two reports on National Defense property, plant, and equipment in DoD. The other report addresses the DoD-wide prior period adjustment for removal of National Defense property, plant, and equipment.

**Objectives.** The overall audit objectives were to determine whether the Military Departments were consistently identifying National Defense property, plant, and equipment as defined in the Statement of Federal Financial Accounting Standards No. 11, "Amendments to Accounting for Property, Plant, and Equipment: Definitional Changes," October 1998, and whether the amount of the prior period adjustment that removed National Defense property, plant, and equipment from the balance sheet was correct. Since the prior period adjustments were one-time events, no management control program applies to them. Therefore, a review of management controls for this audit was not required. The report covers only the original prior period adjustment that removed military equipment from the balance sheet of the Army General Fund.

**Results.** The Army General Fund financial statements incorrectly stated that the entire $144.5 billion prior period adjustment was made to remove National Defense property, plant, and equipment from the balance sheet. As a result, the statements incorrectly implied that the Army General Fund had $144.5 billion in National Defense property, plant, and equipment on the balance sheet as of September 30, 1997 (the end of the prior accounting period). The statements also did not disclose the fact that prior period adjustments were made for other purposes, including major adjustments to general property, plant, and equipment and the accrual of an environmental liability. If the dollar values of National Defense property, plant, and equipment had been reported for FY 1998 and FY 1999, they would have been incorrect or inconsistent with the $144.5 billion

adjusting entry. In addition, future statements showing the dollar value of National Defense property, plant, and equipment will not be consistent with the FY 1998 statements. For details of the audit results, see the Finding section of the report.

**Summary of Recommendations.** We recommend that the Defense Finance and Accounting Service Indianapolis Center, Indianapolis, Indiana, implement the existing guidance requiring full explanation of all prior period adjustments in the notes to the financial statements. We also recommend that the Defense Finance and Accounting Service Indianapolis Center correct the erroneous statements about the prior period adjustment in future financial statements of the Army General Fund and present, with any appropriate disclaimers, the dollar amounts for National Defense property, plant, and equipment.

**Management Comments.** The Defense Finance and Accounting Service concurred with the recommendation to implement existing guidance requiring full explanation of all prior period adjustments. However, the Defense Finance and Accounting Service did not concur with disclosing the erroneous statement about the prior period adjustment and the correct valuations of National Defense property, plant, and equipment, in future financial statements. The Defense Finance and Accounting Service considered the additional disclosures inappropriate and unnecessary. See Finding section of the report for a discussion on the management comments and the Management Comments section for the complete text.

**Audit Response.** Management comments are partially responsive. The Defense Finance and Accounting Service does not address the effects of representing the entire adjustment as National Defense property, plant, and equipment. The effects, as outlined in the finding, are the reasons we consider it both necessary and appropriate to disclose the erroneous statement about the prior period adjustment, and the correct valuations of National Defense property, plant, and equipment, in future financial statements. We request that the Director, Defense Finance and Accounting Service, provide comments on the final report by September 19, 2000.

# Table of Contents

## Background

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. This audit report addresses the prior period adjustment to the net position of the Army General Fund. The Army reported that the entire adjustment of $144.5 billion was to remove National Defense property, plant, and equipment (PP&E) from the Army General Fund balance sheet, as part of the reporting of Required Supplementary Stewardship Information (RSSI). The Defense Finance and Accounting Service (DFAS) Indianapolis Center, Indianapolis, Indiana, prepares the Army General Fund financial statements. For the FY 1998 and FY 1999 reporting cycles, we concurred with the Army Audit Agency's disclaimer of opinion on the Army General Fund financial statements.

**Property, Plant, and Equipment Reporting Requirements.** Statement of Federal Financial Accounting Standards (SFFAS) No. 6, "Accounting for Property, Plant, and Equipment," November 1995, is the first SFFAS to address accounting and reporting requirements for PP&E. It established two categories of Federal PP&E: general PP&E and stewardship PP&E.

**General PP&E.** SFFAS No. 6 defines general PP&E as any property, plant, and equipment used in providing goods or services. It also prescribes accounting and reporting requirements for general PP&E. General PP&E is recorded at cost on the balance sheet and, except for land, the cost is depreciated over the estimated useful life of the assets.

**Stewardship PP&E.** SFFAS No. 6 defines three categories of stewardship PP&E; National Defense PP&E (formerly Federal mission PP&E) is one of the three categories. In most cases, the dollar value of stewardship PP&E is not included in the balance sheet. See Appendix C for definitions of the three categories.

SFFAS No. 8, "Supplementary Stewardship Reporting," June 1996, added two broad areas of stewardship reporting to stewardship PP&E: stewardship investments and stewardship responsibilities. SFFAS No. 8 also established reporting requirements for all three stewardship categories. All stewardship reporting is in the RSSI section of the financial statements. Both SFFAS No. 6 and SFFAS No. 8 became effective for fiscal periods beginning after September 30, 1997, making FY 1998 the implementation year.

SFFAS No. 11, "Amendments to Accounting for Property, Plant, and Equipment: Definitional Changes," October 1998, and Statement of Recommended Accounting Standards No. 16, "Amendments to Accounting for Property, Plant, and Equipment, Measurement and Reporting for Multi-Use Heritage Assets," July 1999, will both affect PP&E reporting. However, neither was in effect for FY 1998.

**Prior Period Adjustments of Property, Plant, and Equipment.** For each category of stewardship PP&E, SFFAS No. 6 requires that amounts previously recognized as assets be removed from the balance sheet. Acquisition costs of the stewardship PP&E, minus the associated accumulated depreciation, must be subtracted from the amounts that represented assets in the PP&E section of the balance sheet as of September 30, 1997. The net amounts removed were to be offset with a reduction to the net position of the entity, reported as a prior period adjustment. The amount of the prior period adjustment associated with removal of the stewardship PP&E was to be disclosed in a footnote.

Because general PP&E would continue to be reported on the balance sheet, no prior period adjustment to remove it was required. However, SFFAS No. 6 requires that both the cost and accumulated depreciation to date of any unrecognized general PP&E be recorded in the implementation year, with the net amount recognized as a prior period adjustment in the statement of changes in net position. Such adjustments would be additions to the balance sheet rather than deletions from it.

**DoD Reporting of National Defense PP&E for FY 1998.** DoD, including the Army General Fund, reported quantities of National Defense PP&E for FY 1998 when it should have reported the dollar value as prescribed by SFFAS No. 8. We discussed the problem in Inspector General, DoD, Audit Report No. 99-210, "Stewardship Reporting in the DoD Agency-Wide Financial Statements for FY 1998," July 9, 1999, but we acknowledged that the guidance was confusing at that time. Although the guidance had not changed, DoD again reported quantities rather than dollar values of National Defense PP&E for FY 1999. Inspector General, DoD, Audit Report No. D-2000-091, "Internal Controls and Compliance With Laws and Regulations for the DoD Agency-Wide Financial Statements for FY 1999," February 25, 2000, addresses the matter.

**RSSI Audit Requirement.** The Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," establishes the minimum requirements for audits of Federal financial statements. For FY 1998, OMB removed the requirement to audit RSSI for the purpose of rendering an opinion on it. Instead, auditors were to apply the less extensive procedures appropriate for reviewing required supplementary information. As a result of the OMB action, we were not required to render an opinion on RSSI for FY 1998 or FY 1999.

## Objectives

Our overall audit objectives were to determine whether the Military Departments were consistently identifying National Defense PP&E as defined in SFFAS No. 11, "Amendments to Accounting for Property, Plant, and Equipment: Definitional Changes," October 1998, and to determine whether the amount of the prior period adjustment removing National Defense PP&E from the balance sheet was correct. Because the prior period adjustments were one-time events, no management control program applies to them. Therefore, a review of management controls for this audit was not required. This report covers only the correctness of the prior period adjustment to the Army General Fund financial statements and the effect it had on the values shown for National Defense PP&E for FY 1999 and beyond. Appendix A discusses the scope and methodology, and prior audit coverage is in Appendix B.

# The Prior Period Adjustment for Army National Defense Property, Plant, and Equipment

The Army General Fund financial statements incorrectly stated that the entire $144.5 billion prior period adjustment was made to remove National Defense property plant and equipment (PP&E) from the balance sheet. The financial statements were incorrect because DFAS Indianapolis Center based $29.9 billion, or 21 percent, of the $144.5 billion on adjusting journal entries that were unrelated to National Defense PP&E. The remaining $114.6 billion was based on journal entry adjustments annotated as removals of National Defense PP&E but actually included corrections to general PP&E. As a result, the statements incorrectly reported that the Army General Fund had $144.5 billion in National Defense PP&E on the balance sheet as of September 30, 1997 (the end of the prior accounting period), and did not disclose the fact that adjustments were made for other purposes. In addition, FY 1999 and future statements showing the dollar value of National Defense PP&E will not be consistent with the FY 1998 statements.

## Breakdown of the Prior Period Adjustment

The DFAS Indianapolis Center prepares accounting entries and financial statements for the Army General Fund. According to the notes to the Army General Fund financial statements, the entire $144.5 billion prior period adjustment was to remove National Defense PP&E from the balance sheet. The $144.5 billion was actually the balance of the prior period adjustment account after posting a number of accounting journal entries. Of the $144.5 billion posted, $114.6 billion was based on journal entries annotated as removals of National Defense PP&E from the balance sheet. The other entries, totaling $29.9 billion, were for purposes other than to remove National Defense PP&E. The journal entries were subdivided into seven groups, as shown in the following table.

**Breakdown of the Prior Period Adjustment Journal Entries**

| Purpose of Entry as Labeled | Prior Period Adjustment (billions) |
|---|---|
| Removal of personal property National Defense PP&E | $ 2.5 |
| Removal of real property National Defense PP&E | 19.7 |
| Removal of war reserves National Defense PP&E | 32.4 |
| **Subtotal - Entries labeled for removal of National Defense PP&E** | **$114.6** |
| Army Audit Agency adjustments to general PP&E | $ 7.9 |
| Accrual of environmental liability | 25.7 |
| Other supported adjustments | (6.8)[1] |
| Unsupported adjustments | 3.1[2] |
| **Subtotal - Adjustments for other purposes or unsupported** | **$ 29.9** |
| **Total** | **$144.5** |

[1]Negative amounts represent additions to the net position of the Army General Fund.
[2]The total unsupported general ledger adjustments for FY 1998 were $672.9 billion. See Inspector General, DoD, Report No. 99-153, "Compilation of the FY 1998 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," May 12, 1999, for more detail.

## Adjusting Entries to Remove Stewardship PP&E

Except for war reserves, the adjusting journal entries that removed National Defense PP&E ($114.6 billion) were not based on any estimated or actual value of National Defense PP&E. Instead, the adjustments merely brought the balances of applicable general ledger accounts into agreement with determined values for general PP&E remaining on the balance sheet. Because the general PP&E determined asset values correctly omitted stewardship PP&E, such adjustments would cover both the removal of stewardship PP&E and any corrections to general PP&E. The result would be a correct total adjustment and accurate amounts on the balance sheet.

**National Defense PP&E Personal Property, Other Than War Reserves.** For the FY 1998 financial statements, the Army Logistics Support Activity (LOGSA) conducted a major data call to all Army units to report all equipment of any kind. The principal purpose of the data call was to identify general PP&E. LOGSA used the data call to provide financial statement data for general PP&E that included acquisition cost and accumulated depreciation from the date of acquisition through September 30, 1998. For National Defense PP&E, the amount to be removed from the balance sheet was the recorded acquisition cost as of September 30, 1997.

Using entries with adjustments totaling about $62.5 billion, DFAS Indianapolis Center adjusted the applicable general ledger general PP&E account balances to agree with the LOGSA results, including depreciation. The notations on the journal entries stated that the $62.5 billion adjustment was made to remove National Defense PP&E personal property from the balance sheet, although no value associated with National Defense PP&E was used to calculate the adjustments.

In contrast with its reliance on LOGSA dollar values for general PP&E, DFAS Indianapolis Center did not use LOGSA-supplied dollar values for National Defense PP&E. LOGSA supplied both quantities and dollar values for National Defense PP&E personal property, although only quantities were reported. The DFAS Indianapolis Center used the LOGSA quantities of National Defense PP&E in the RSSI, but did not use the dollar values that LOGSA associated with the same assets. The LOGSA dollar value corresponding with the quantities that it provided was $107 billion, much greater than the $62.5 billion of National Defense PP&E personal property removed from the balance sheet. If DFAS had used the dollar values from LOGSA for both general and National Defense PP&E, one adjusting entry of $107 billion would have been required to remove the National Defense PP&E, and another entry of $44.5 billion would be necessary to revalue the general PP&E.

Although we did not audit the LOGSA FY 1998 values and do not attest to their accuracy, the $62.5 billion in entries included substantial net additions to general PP&E. SFFAS No. 6 anticipated an adjustment to add general PP&E not previously recognized during the implementation year (see the Background section in this report), and the Army sent out a data call mainly to identify such general PP&E. Even with the uncertainty of the values and the fact that LOGSA National Defense PP&E values were for FY 1998 instead of FY 1997, the adjustment included a substantial correction to general PP&E. Therefore, we find no basis for the statement that it was all for the removal of National Defense PP&E.

The journal entry notations, and especially the financial statements, should have disclosed that the entries were a combination of removing National Defense PP&E and an adjustment to general PP&E. If DFAS Indianapolis Center did not know how much applied to each, the uncertainty should have been disclosed in the footnote.

**National Defense PP&E Real Property.** As LOGSA did for personal property, the Assistant Chief of Staff of the Army for Installation Management (ACSIM) provided dollar values for general PP&E real property and quantities for National Defense PP&E real property (ammunition bunkers and missile silos in active use). Unlike LOGSA, ACSIM did not provide dollar values for National Defense PP&E real property for the Army General Fund financial statements. The DFAS Indianapolis Center made accounting entries based on the ACSIM general PP&E dollar values in the same manner as for personal property, making existing account balances agree with the ACSIM general PP&E real property values. The entries resulted in a total adjustment of about $19.7 billion. The entries were annotated to indicate that the entire adjustment was made to remove National Defense PP&E real property from the balance sheet. ACSIM could not reconstruct National Defense PP&E real estate as of September 30, 1997. Nevertheless, as of September 30, 1999, the value was $314 million, much less

than $19.7 billion. The annotations and the statements should have disclosed that the adjustment was a combination of removing National Defense PP&E, and revaluing general PP&E, and FY 1999 and future statements need to explain the large reduction in National Defense PP&E real estate.

**National Defense PP&E War Reserves.** Unlike the other two sets of adjustments, the National Defense PP&E war reserves entries used general ledger values associated with National Defense PP&E. They used the correct method, except that the values used were as of September 30, 1998, instead of September 30, 1997. Therefore, part of the $32.4 billion represented current period activity rather than a prior period adjustment. However, the problem in methodology was relatively minor compared with the problems with adjustments for personal property and real property. A significant problem with one of the figures used for the war reserve adjustment is described at the end of this section.

For most categories of war reserves, the applicable general ledger accounts were zeroed out. Regardless of the correctness of those prior account balances, zeroing out the accounts was the equivalent of removing amounts previously recognized as assets.

SFFAS No. 11 states that ammunition and munitions should remain on the balance sheet as operating materials and supplies rather than being treated as National Defense PP&E. For conventional ammunition, the applicable general ledger accounts represented only ammunition and munitions, and DFAS Indianapolis Center correctly made no prior period adjustments to the accounts.

For missiles, the required adjustment was more complex. SFFAS No. 11 defines missiles as unmanned, expendable, self-propelled flying vehicles with some form of guidance system that allows them to be steered toward, rather than aimed at, the target, and states that missiles are National Defense PP&E. However, the Army has recorded the dollar values both of missiles that fit the SFFAS National Defense PP&E description, and of missiles that were similar to ammunition and munitions, in a single set of accounts. Therefore, the Army had to determine an amount corresponding to the missiles that fit the SFFAS No. 11 description to remove them from the balance sheet. LOGSA provided such a value for the self-guided missiles, and the DFAS Indianapolis Center removed only that amount from the applicable account balances. However, working with the General Accounting Office, we found that the value that LOGSA provided was significantly overstated.

According to the General Accounting Office, in the course of providing a value for missiles considered to be National Defense PP&E for FY 1999, LOGSA realized that its FY 1998 figure of $13.255 billion included wholesale missiles twice. Therefore, the total of $32.4 billion in adjustments to remove National Defense PP&E war reserves from the balance sheet was overstated by at least $4.9 billion. LOGSA corrected the error in the FY 1999 financial statements.

**Heritage Assets and Stewardship Land.** No accounting entries were specifically made to remove Army General Fund heritage assets or stewardship land from the balance sheet. DFAS Indianapolis Center personnel stated that in previous years, personal property heritage assets were added for financial statement purposes, but were not added for FYs 1998 and 1999. They assumed that real property heritage assets and stewardship land were omitted from the

general PP&E amounts and were therefore removed from the balance sheet by the adjusting journal entries.

The DFAS Indianapolis Center reported heritage assets and stewardship land for the Army General Fund. However, the amounts were not material to the Army General Fund financial statements. Because the recently determined values for general PP&E properly omitted heritage assets and stewardship land, the required removals were automatically included in the entries to make real property and personal property general ledger balances agree with the new general PP&E values. Based on the prior financial statements and on data from ACSIM, we estimated that the total adjustments to remove heritage assets and stewardship land were $0.1 billion or less. Because of the low dollar impact, the absence of separate disclosure of the amounts as required by SFFAS No. 6 was not material to the financial statements. Accordingly, we will not discuss heritage assets or stewardship land further in this report.

## Effects of Representing the Entire Adjustment as National Defense PP&E

The lack of specificity in the note explaining the prior period adjustment was not in compliance with the DoD guidance for financial statement preparation for Fys 1998 and 1999. According to DoD Regulation 7000.14-R, volume 6B, "Form and Content of Department of Defense Audited Financial Statements," December 1998 (the DoD Form and Content), entities were to disclose the nature and amount of significant prior period adjustments. They were to identify specifically any amounts greater then $100 million. The DoD Form and Content in effect for FY 1999 financial statement reporting repeated the foregoing requirement and added another specific requirement to disclose the offsetting charge for any cleanup cost (or environmental) liability. Of the amount not specifically disclosed, $25.7 billion was for accrual of an environmental liability.

The effects of representing the entire adjustment as National Defense PP&E go beyond the failure to disclose the portions that removed stewardship PP&E as required by SFFAS No. 6 and the DoD Form and Content. Financial statement readers could be misled into determining that the Army General Fund had National Defense PP&E of $144.5 billion as of September 30, 1997, that needed to be removed from the balance sheet. They might also conclude that the National Defense PP&E quantities reported in the financial statements would have a value equal to the $144.5 billion, adjusted for any current year additions and deletions. The implications leading to the erroneous conclusions do not comply with applicable concepts of Federal financial accounting.

Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, "Objectives of Federal Financial Reporting," September 2, 1993, states that information in financial reporting should represent what it purports to represent. SFFAC No. 2, "Entity and Display," April 20, 1995, states that accompanying footnotes to financial statements are an integral part of the statements and are needed to make the statements more informative and not misleading. The footnote was misleading because the $144.5 billion prior period adjustment represented more than the removal of National Defense PP&E from the balance sheet.

SFFAC No. 1 also states that no material information should be omitted. In this case, the Army General Fund FY 1998 financial statements omitted the fact that prior period adjustments of $29.9 billion were made for reasons unrelated to National Defense PP&E. As specific examples, the statements did not disclose that $25.7 billion was accrued as an environmental liability, or that general PP&E personal property was adjusted upward by as much as $44.5 billion.

Finally, SFFAC No. 1 requires financial reports to be consistent over time. For FY 1999, as for FY 1998, the Army should have reported National Defense PP&E by dollar value, but again has reported it by quantity. The requirement is to show a beginning dollar value, additions, deletions, and a net ending dollar value. If the Army General Fund had reported National Defense PP&E correctly for FY 1999, an explanation would have been needed as to why the beginning amount reported was not $144.5 billion. Although a decision on where National Defense PP&E will be reported is still pending, we believe that the Federal Accounting Standards Advisory Board will continue with the requirement to show the National Defense PP&E dollar values.

## Recommendations, Management Comments, and Audit Response

**We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center:**

**1. Implement the DoD Regulation 7000.14-R, volume 6B, "Form and Content of the Department of Defense Audited Financial Statements" guidance that requires all prior period adjustments be fully explained in the footnotes.**

**Management Comments.** DFAS concurred and stated that it had made every effort to fully disclose material conditions but had been limited by the quality and timeliness of information from supporting accounting and logistics offices. DFAS stated that it would work with the supporting offices to improve the area during FY 2000. DFAS expects completion by January 31, 2001.

**2. In future Army General Fund statements:**

**a. Disclose the erroneous valuation of National Defense property, plant, and equipment removed from the financial statements.**

**b. State the value of the National Defense property, plant, and equipment reported for FY 1998, with any necessary disclaimers on the accuracy of the amount.**

**c. Restate what the FY 1998 adjustment actually represented.**

**Management Comments.** DFAS did not concur and stated that it is not appropriate or necessary to address the FY 1998 prior period adjustment narrative misstatement. DFAS also stated that it was unnecessary to address the FY 1998 value of the National Defense property, plant, and equipment, and that it was also unnecessary to restate the prior period adjustment in the FY 2000 and future financial statements.

**Audit Response.** DFAS comments are not responsive in that they do not address the effects of representing the entire adjustment as National Defense PP&E. Further, the DFAS position would be inconsistent with the Statements of Federal Financial Accounting Concepts 1 and 2. Without later correction, financial statement users will continue to overvalue Army General Fund PP&E at the $144.5 billion reported as of September 30, 1998. In addition, the users of the statements would not be aware that some of the $144.5 billion was to revalue General PP&E, establish the accrual environmental liability needed for the Army, and make other adjustments that were not associated with National Defense PP&E. Furthermore, future financial statements that report a dollar value of National Defense PP&E would not be supported by a starting value of $144.5 billion reported as of September 30, 1998, without additional explanation. We request that DFAS reconsider its position on the necessity of addressing the FY 1998 prior period adjustment narrative misstatement in future financial statement footnotes or narratives. It should be noted that we do not want the financial statements for FY 1998 or FY 1999 restated.

# Appendix A. Audit Process

## Scope

**Work Performed.** We reviewed the journal entries underlying the Army General Fund prior period adjustment and supporting documentation. We focused on the entries that were labeled as removing National Defense PP&E from the balance sheet, but we also reviewed the other entries enough to verify that they were for other purposes. We also reviewed the FY 1998 Army General Fund financial statements and the submissions from LOGSA and ACSIM on the values of general and National Defense PP&E as of September 30, 1998. We were not required to and did not render an opinion on the RSSI statements.

We interviewed personnel and reviewed records at the DFAS Indianapolis Center and LOGSA. We checked the basic methodology of the journal entries and the use of LOGSA and ACSIM data.

**Limitations to Audit Scope.** We were unable to determine exactly what the amounts of the adjustments should have been. The correct amounts would have been the amounts on the Army General Fund balance sheet as of September 30, 1997, that represented the various types of stewardship PP&E. LOGSA and ACSIM did not calculate the amounts because RSSI was not a requirement in FY 1997. The Army General Fund FY 1997 balance sheet had a value for military equipment, but the value did not correspond to National Defense PP&E for FY 1998.

We did not audit the LOGSA and ACSIM figures as of September 30, 1998, because they gave only an approximate idea of what the September 30, 1997, amounts would have been, and because the Army Audit Agency had already tried unsuccessfully to audit them. Army Audit Agency Report No. AA 99-158, "Army's Principal Financial Statements for Fiscal Year 1998 - Summary Audit Report," February 18, 1999, states that the reporting process for RSSI did not provide reasonable assurance that the information was accurate and complete. We did not audit the figures previously because, in general, the FY 1998 DoD financial statements were issued too late for us to audit them in a timely fashion. Additionally, no audit opinion on RSSI was required for FY 1998.

Because the prior period adjustments were one-time events, no management control program applies to them. Therefore, a review of management controls for this audit was not required.

**DoD-Wide Corporate-Level Government Performance and Results Act Coverage.** In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 DoD Corporate Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

**General Accounting Office High-Risk Areas.** The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

## Methodology

**Use of Computer-Processed Data.** We are reviewing LOGSA and ACSIM systems tracking stewardship PP&E for FY 1999. For this report, we used only system outputs that LOGSA and ACSIM provided to the DFAS Indianapolis Center. The report concerns what the DFAS Indianapolis Center did with the amounts, not the accuracy of the amounts. Therefore, although we did not establish the reliability of the LOGSA and ACSIM databases, the results reported in this report are not materially affected.

**Audit Type, Dates, and Standards.** We conducted this financial-related audit from June 1999 through February 2000 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

**Contacts During the Audit.** We visited or contacted individuals and organizations within DoD. Further details are available on request.

# Appendix B. Summary of Prior Coverage

## General Accounting Office

U.S. General Accounting Office Report No. AIMD-99-130 (OSD Case No. 1801), "1998 Financial Report of the United States Government," March 31, 1999.

## Department of Defense

Inspector General, DoD, Report No. D-2000-091, "Internal Controls and Compliance With Laws and Regulations for the DoD Agency-Wide Financial Statements for FY 1999," February 25, 2000.

Inspector General, DoD, Report No. D-2000-087, "Inspector General, DoD, Oversight of the Army Audit Agency Audit of the Army's General Fund Principal Financial Statements for Fiscal Year 1999," February 14, 2000.

Inspector General, DoD, Report No. 99-210, "Stewardship Reporting in the DoD Agency-Wide Financial Statements for FY 1998," July 9, 1999.

Inspector General, DoD, Report No. 99-153, "Compilation of the FY 1998 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," May 12, 1999.

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## Army

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Army Audit Agency Report No. AA 99-191, "Army's Principal Financial Statements for Fiscal Year 1998 - Supplemental Stewardship Reporting of National Defense Equipment," March 24, 1999.

Army Audit Agency Report No. AA 99-158, "Army's Principal Financial Statements for Fiscal Year 1998 - Summary Audit Report," February 18, 1999.

Army Audit Agency Report No. AA 99-112, "Army's Principal Financial Statements for Fiscal Years 1998 and 1997 - Financial Reporting of Equipment - Follow-up Issues," January 15, 1999.

Army Audit Agency Report No. AA 99-108, "Army's Principal Financial Statements for Fiscal Years 1998 and 1997 - Financial Reporting of Equipment - Reportable Item Control Codes," December 31, 1998.

Army Audit Agency Report No. AA 98-172, "Army's Principal Financial Statements for Fiscal Years 1997 and 1996 - Accountability for Army Mission Equipment," May 4, 1998.

# Appendix C. Categories and Reporting Requirements for Stewardship Property, Plant, and Equipment

The three categories of stewardship PP&E and the reporting requirements for them are as follows.

**National Defense PP&E (Originally Federal Mission PP&E).** The National Defense PP&E category consists of weapon systems and support PP&E owned by DoD or its component entities for use in the performance of military missions and vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. National Defense PP&E is typically held for use in the event of war or other emergency. Additional characteristics of National Defense PP&E are an indeterminate or unpredictable useful life and a high risk of being destroyed during use or becoming obsolete prematurely. For those reasons, the usual depreciation of roughly equal portions of the cost over the estimated useful life, starting at the time of acquisition, does not reflect the way the assets are actually used. Starting in FY 1998, costs of acquisition and improvement of National Defense PP&E were to be recognized as expenses in the year incurred.

SFFAS No. 8 requires the reporting of National Defense PP&E as RSSI in dollars at acquisition cost. The requirement was in effect at the time of the audit. Therefore, the cost of National Defense PP&E removed from the balance sheet, adjusted for the intervening years' activity, should be reconcilable with cost reported as RSSI.

**Heritage Assets.** Heritage assets are PP&E unique for historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage assets are divided into collection-type heritage assets, such as items in a museum, and noncollection-type assets, such as historic buildings. Except as noted in this section, the expectation is that heritage assets will be preserved rather than used and will be kept for an indefinite period. Additionally, there may be no acquisition cost, and it may be impossible to determine any reasonable value. Unlike National Defense PP&E, reporting of heritage assets in RSSI is in physical units, not dollars. New acquisition and improvement costs are to be expensed as incurred.

Multi-use heritage assets, generally noncollection type, consist of PP&E items that have the properties of heritage assets and are also used in Government operations. Statement of Recommended Accounting Standards No. 16 (in Congress for review before issuance as SFFAS No. 16), "Amendments to Accounting for Property, Plant, and Equipment, Measurement and Reporting for Multi-Use Heritage Assets," July 1999, states that the assets should remain on entity balance sheets, in dollars, as general PP&E. They are also to be reported on the heritage asset statement in physical units. New acquisition and improvement costs are to be capitalized and depreciated rather than expensed. Therefore, the adjustment to remove heritage assets from the balance sheet would not include multi-use heritage assets. Although the effective date for SFFAS No. 16 is FY 2000, DoD had already taken the prescribed approach to accounting for multi-use heritage assets.

**Stewardship Land.** Stewardship land is land owned by the Federal Government and not acquired for or in connection with general PP&E. Examples in SFFAS No. 6 are forests, parks, and land used for wildlife and grazing. As with heritage assets, reporting is in physical units such as acres, not dollars. Further interpretations of SFFAS No. 6 extend the definition to donated land and land allocated from the public domain, for which no acquisition cost is available, and for which a determination of the value may be difficult. That further interpretation can include land used operationally; in fact, a large number of active military bases are located on former public domain land. The cost of land, including general PP&E land, is never depreciated. Any new costs to acquire or improve stewardship land are expensed as incurred.

# Appendix D. Report Distribution

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House Committee on Appropriations
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House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

# Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291
WWW.DFAS.MIL

JUN -7 2000

DFAS-HQ/ASF

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Army Prior Period Adjustment to Remove National Defense Property, Plant, and Equipment From the General Fund Balance Sheet (Project No. D2000FH-2109.001) (formerly Project No. 0FH-2109.01)

Our response to the subject audit is attached. The primary point of contact (POC) is Mr. Wayne Ebaugh, (703) 607-2857 or DSN 327-2857, and the secondary POC is Mr. Mike Bryant, (703) 607-1562 or DSN 327-1562.

Edward A. Harris
Director for Accounting

Attachment:
As stated

cc:
DFAS-HQ/DI
DFAS-IN/XP

**DFAS Comments on DoDIG Audit Report on Army Prior Period Adjustment to Remove National Defense Property, Plant, and Equipment From the General Fund Balance Sheet (Project No. D2000FH-2109.001) (formerly Project No. 0FH-2109.01)**

**Responses to Recommendations**

We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center:

**Recommendation 1:** Implement the DoD Regulation 7000.14-R, Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements" guidance that requires all prior period adjustments be fully explained in the footnotes.

**DFAS Management Comments**: Concur. The Defense Finance and Accounting Service Indianapolis Center (DFAS-IN) has made every effort to fully disclose all material conditions that either require disclosure as prescribed by regulation or materially impact the financial statements. However, DFAS is limited in the quality and timeliness of the information by what is received from supporting accounting and logistics offices. During fiscal year (FY) 2000, we will work with supporting accounting and logistics activities to improve this critical area.

**Completion Date**: January 31, 2001.

**Recommendation 2:** In future Army General Fund statements:

a. Disclose the erroneous valuation of National Defense property, plant, and equipment removed from the financial statements.

**DFAS Management Comments**: Nonconcur. The value of National Defense property, plant, and equipment (PP&E) that was removed from the Balance Sheet for FY 1998 was correct. The narrative description of the prior period adjustment was incorrect. Regardless, it is inappropriate and unnecessary to address the FY 1998 National Defense PP&E prior period adjustment narrative misstatement in the FY 2000 and other future financial statements.

b. State the value of the National Defense property, plant, and equipment reported for FY 1998, with any necessary disclaimers on the accuracy of the amount.

**DFAS Management Comments**: Nonconcur. It is inappropriate and unnecessary to address the FY 1998 value of the National Defense PP&E prior period adjustment, with any disclaimers, in the FY 2000 and other future financial statements.

c. Restate what the FY 1998 adjustment actually represented.

**DFAS Management Comments**: Nonconcur. It is inappropriate and unnecessary to address the FY 1998 value of the National Defense PP&E prior period adjustment, with any disclaimers, in the FY 2000 and other future financial statements. The adjustment to remove National Defense PP&E from the Balance Sheet was done in the FY 1998 statements and has no impact on future years' financial statements. Therefore, no additional disclosures are required by the Department of the Army or the DFAS.

# Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
David F. Vincent
John A. Richards
Tyler C. Apffel
Kandy T. Sutton
Anissa M. Nash-Brooks
Susanne B. Allen

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